No. 10249.

IN THE

United States Circuit Court of Appeals

FOR THE NINTH CIRCUIT

ELSA METZ MASON,

Appellant,

vs.

THOMAS MITCHELL,

Appellee.

BRIEF OF APPELLEE THOMAS MITCHELL.

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Statement of Case and Question Involved.

The statement of the case as made in the appellant's opening brief is a very fair statement of the facts. We differ only with him in that portion of the brief, however, on the question involved. The question which was submitted to the lower court was not merely one of pleading. The Referee in Bankruptcy before whom the matter was tried took the position that if he listened to four or five days' court time to determine the issue of whether there was or was not, in fact, a partnership between the parties, he felt no good could result for the reason that the parties had already stipulated on the issue of insolvency. The parties had mutually stipulated that the alleged partner,

Thomas Mitchell, over and above his exempt property, had sufficient property to pay all of the alleged partner's debts and all of his own debts. The Referee therefore correctly concluded that if the partnership was solvent, no cause for a bankruptcy adjudication existed. The district judge affirmed.

ARGUMENT.

Answering Point 1: The question involved here is not a question of the sufficiency of the pleading but one of the sufficiency of the proof.

Counsel for the appellant attempts to make it appear that the question which was before the lower court depends on a question of pleading. His argument is based all on his Point 1. The amendment to the Bankruptcy Act, to-wit, the Chandler Act in 1938 made a change only in the question of pleading. It did not change the question of insolvency; it did not change the liability of partners, to-wit, that each partner is liable for all of the debts of the partnership; it did not change the substantive law that if a partnership is adjudicated a bankrupt as an entity, that the assets of the individual partners may be brought into that partnership bankruptcy to pay the partnership debts *without adjudicating the individual partners bankrupt.*

There is nothing new in the entity theory of a partnership for adjudication purposes presented by the Chandler Act of 1938. Courts have been adjudicating partnerships as such long before the effective date of the Chandler Act. We are not concerned with the entity theory here. It is immaterial whether one Circuit Court clings to the entity theory and another does not.

There can be no difference of opinion on the question cited that a partnership may be adjudicated a bankrupt without reference to the bankruptcy of the individual partners. The *Liberty National Bank* case is the destination end of the *West Virginia* case starting in 1920. The serial history of this case is found in 2 A. B. R., New Series, 545; 3 A. B. R., New Series, p. 8; 5 A. B. R., New Series, 310; 9 A. B. R., New Series, 303, and 11 A. B. R. 343.

The quotation by opposing counsel of a portion only of that opinion in *Liberty National Bank v. Baer,* 276 U. S. 215, should be qualified by the statement that the question in that case was not the question involved in the instant case. In that decision the Court itself expressly said that the question relating to partnership entity was not present and any reference to the question involved in that case here involved is *obiter.*

We quote from *Liberty National Bank v. Baer,* at page 219:

> "The controversy here is solely between the bank and the trustee as the representative of the other individual creditors of the Beckers."

And the footnote to the opinion itself on page 224 says:

> "Neither of the two incidental questions upon which the lower federal courts have differed in opinion —whether a partnership can be deemed insolvent as an entity when the individual partners are solvent, and whether a bankruptcy court which has adjudged a partnership a bankrupt may take possession of the individual property of a partner who has not been adjudged a bankrupt so far as is necessary to pay the partnership debts—is here involved."

A Partnership Is Not Insolvent When Any Partner Has Property Sufficient to Pay All the Debts of the Partnership.

There can be no question that prior to the effective date of the Chandler Act in September, 1938, the insolvency of a partnership was determined by taking into consideration the sum total of all of the property of the partnership, together with all the property of the individual members of the partnership. Every known text-book writer on bankruptcy has agreed on this.

Remington, Vol. 4, Sec. 1746:

"Sec. 1746. Partnership Not Insolvent, Unless All Partners Insolvent. A partnership is not to be deemed insolvent unless the aggregate of all its own property, together with all of the individual property of its members in excess of their respective individual indebtedness, is less than its liabilities."

Citing:

"Crancer & Co. v. Wade, 25 A. B. R. 880, 26 Okla. 757, 110 Pac. 778; Francis v. McNeal, 26 A. B. R. 555, 186 Fed. 481 (C. C. A., Pa.); *In re* Duke & Son, 28 A. B. R. 195, 199 Fed. 199 (D C. Ga.); Washington Cotton Co. v. Morgan & Williams, 27 A. B. R. 838, 192 Fed. 310 (C. C. A., Ga., affirming *In re* Morgan & Williams, 25 A. B. R. 861, 192 Fed. 310); *In re* Wood, 40 A. B. R. 810, 248 Fed. 246 (C. C. A., Ky.); Fort Pitt Coal Co. v. Diser, 38 A. B. R. 566, 239 Fed. 443 (C. C. A., Ohio); *In re* Samuels & Lesser, 32 A. B. R. 436, 215 Fed. 845 (C. C. A., N. Y., reversing s. c. 30 A. B. R. 293, 207 Fed. 195); *In re* Kobre and Ginsberg, 35 A. B. R. 389, 224 Fed. 106 (D. C., N. Y.); Abbott v. Anderson, 33 A. B. R. 383, 265 Ill. 285, L. R. A. 1915F, 668, 106 N. E. 782."

Collier on Bankruptcy, 12th Edition, page 173:

"In determining the question of insolvency the individual property of the partners should be considered. Where the assets of a partnership, together with the individual properties of each partner, exceeds their liabilities, the partnership is not insolvent."

Citing:

Matter of Kobre, et al., 35 A. B. R. 389, 224 Fed. 106.

And again in Collier on Bankruptcy, 12th Edition, page 174:

"It has been well said that this principle is at variance with the universal doctrine that under the present bankrupcy act a partnership is a legal entity, separate from the partners who compose it. But it is now well settled by the weight of authority that if the act of bankruptcy charges is one involving insolvency, the individual property of the partners must be combined with the property of the partnership in determining the insolvency of the partnership; and that a partnership is not bankrupt so long as one of the members who compose it is individually solvent."

Citing:

Francis v. McNeal (Cir. Ct. of App., 3rd Cir.), 26 A. B. R. 555, 186 Fed. 481, affirmed in 228 U. S. 695; 57 L. Ed. 1029.

In that case, the Court said:

"A partnership cannot be adjudged a bankrupt, in an involuntary proceeding, unless it has committed an act of bankruptcy. If the act charged be one involving insolvency, since every partner is liable *in*

solido for all the partnership debts, the adjudication against the partnership must be based on allegations and proofs that the assets of its members, in excess of their individual debts, plus the assets of the partnership, are insufficient to pay the partnership debts. Otherwise there is no partnership insolvency, notwithstanding the entity doctrine."

To the same effect:

Tumlin v. Bryan (C. C. A., 5th Cir.), 21 Am. B. R. 319, 165 Fed. 166, 91 C. C. A. 200, 21 L. R. A. (N. S.) 960.

In *Worrell v. Whitney,* 24 A. B. R. 749, 179 Fed. 1014:

"That doctrine furnishes a direct proceeding against the partnership as a legal entity, but it does not authorize an adjudication of bankruptcy against a partnership, where the act of bankruptcy charged is one involving insolvency, unless as above stated, it is shown that there is an insufficiency of partnership and individual assets to pay the partnership debts. If a partnership is insolvent, in the sense above explained, all the assets of the partnership and its members are needed for the proper winding up of the partnership affairs."

In re Duke & Son (Ref., Ga.), 29 Am. B. R. 93:

"A partnership cannot be compulsorily adjudicated a bankrupt where any partner appears to be solvent to the extent of having a surplus of property over the debts for which he is personally liable and the debts for which he is liable as a member of the firm. Matter of Kobre (D. C., N. Y.), 35 Am. B. R. 389, 224 Fed. 116."

Brandenberg on Bankruptcy, Section 41:

"But the better rule, supported by a recent decision of the Supreme Court, is that the insolvency of the members of the firm as individuals is essential to the insolvency of the partnership, and that all the property which may be made liable for the firm debts must be considered in determining whether or not the copartnership is solvent. Partners are liable *in solido,* and in order that a firm may be adjudged a bankrupt, it must be shown not only that the copartnership is insolvent, but that every one of its members is individually insolvent."

Browne on Bankruptcy, Chapter II, Sec. 7:

"The better view and the true rule appears to be that in partnership bankruptcy, jurisdiction is conditional, *i. e.,* subject to the condition that both the partnership, as such, and all the individual partners, *are* insolvent."

Weinstein on Bankruptcy, Section 5.

Gilbert's Collier on Bankruptcy, 4th Edition, Section 225, page 138:

This author, after discussing the entity theory, says:

"Actually, however, this theory is not adhered to in all instances, as will hereafter appear."

The same author thereafter in Section 228 of the text says:

"There can be no final settlement of a partnership until all the debts are paid."

and quotes from the opinion of Mr. Justice Holmes in *Francis v. McNeal,* 228 U. S. 695:

"The fact remains as true as ever that partnership debts are debts of members of the firm, and that the

individual liability of the members is not collateral like that of a surety, but primary and direct, whatever preference there may be in the marshalling of assets."

And in the text further, Section 231:

"In determining the question of insolvency of a partnership it must not only be shown that the partnership assets are insufficient but also that the assets of individual members, after paying their debts, are not enough to make up the difference. This seems to depart from the doctrine that a partnership is a legal entity, separate from the partners who compose it. Nevertheless, it is well settled that, if the act of bankruptcy charges is one involving insolvency, the individual property of the partners must be combined with the property of the partnership in determining the insolvency of the partnership; and that a partnershiy is not bankrupt so long as one of the members who compose it is individually solvent."

In Black on Bankruptcy, in the text, supported by the following authorities, we find:

"To a certain extent, the latest decisions on the point attempt to reconcile these contrary views, in holding that the property of a solvent partner is not drawn into the administration, where only the firm is adjudged bankrupt, but that if the adjudication is based upon or involves the insolvency of the firm (which necessarily implies the insolvency of each of the partners as well), then even unadjudicated partners may be compelled to turn over their separate assets to the trustee."

Black on Bankruptcy, 4th Ed.

Citing:

Francis v. McNeal, supra (C. C. A., Pa.), affirmed in 228 U. S. 695.

The Statutory Law and the Law Stare Decisis Has Not Been Changed by the Chandler Act nor by Judicial Decisions Subsequent Thereto.

Section 5 of the Chandler Act reads in part:

"Sec. 5. Partners—a. A partnership, including a limited partnership containing one or more general partners, during the continuation of the partnership business or after its dissolution and before the final settlement thereof, *may be adjudged a bankrupt either separately or jointly with one or more or all of its general partners.*

"b. A petition may be filed by one or more or all of the general partners in the separate behalf of a partnership or jointly in behalf of a partnership and of the general partner or partners filing the same: Provided, however, that where a petition is filed in behalf of a partnership by less than all of the general partners, the petition *shall* allege that the partnership *is insolvent.* A petition may be filed separately against a partnership or jointly against a partnership and one or more or all of its general partners."

While Section 67, as re-written in the Chandler Act, by its terms is made applicable exclusively to this subdivision of the Act under the terms of Subdivision d(1), nevertheless it furnishes us with a recital which shows that the rule has not been changed. We quote from a portion of d(1):

"And to determine *whether a partnership is insolvent, there shall be added to the partnership property the present fair salable value of the separate property of each general partner in excess of the amount required to pay his separate debts and also the amount realizable on any unpaid subscription to the partnership of each limited partner.*"

The liability of a partner is one imposed by law for *all* partnership debts and is primary. The definition of a partner in California is essentially different than the definition of a partner in the other forty-seven states. It would appear that the lawmakers in California in early days anticipated that all business ventures would be profitable. In other states, partnerships are defined to be agreements of two or more persons to carry on a venture for the division of profits and the payment of losses. In California, the definition is:

> "Sec. 2400. Partnership defined. (1) A partnership is an association of two or more persons to carry on as co-owners a business for profit."

The liability of a partner for the debts of course exists. That liability is one by which each partner is primarily liable for all the debts. That liability is not one of guaranty, it is not one of surety, it is not a secondary liability.

The Theory of Marshaling Assets, the Taking of the Property of the Individual Partners to Pay Partnership Debts Is Illustrative of the Non-Entity Theory of Partnership.

It appears to us that the best expression which has been given for the reason why a partnership, as such, may be adjudicated a bankrupt apart from the bankruptcy of the individual members who composed the partnership, is the theory of legal fiction. That legal fiction has never been carried to the extent of recognizing it as a legal entity which can hold real property in its own name, or which will permit the entity to sue or be sued in its own name.

That theory as a fiction of law has been used for the purpose of administering the assets of a partnership, but the law has never released the partners from their individual liability to pay all the debts of the partnership out of their individual assets. The Chandler Act of 1938, as the law previous to that time, recognizes the equitable theory of marshalling assets. It makes the provision a statutory one. Subdivision d of Section 5, under the title "Partners" reads:

> "d. The court of bankruptcy which has jurisdiction of one of the general partners may have jurisdiction of *all the general partners* and of the administration *of the partnership and individual property.*"

As long as the doctrine of marshalling assets exists, and as long as the primary liability of a partner for partnership debts exist, then the law must require the marshalling of assets in the other sense to determine insolvency. To limit the inquiry for the purpose of insolvency solely to the assets of the partnership and excluding the individual assets of the partners is to deny the very theory upon which the marshalling of assets is based, to-wit, the primary liability of the partners.

Loveland on Bankruptcy, Section 258, at page 535:

> "The test of solvency or insolvency of a partnership is whether the firm debts may be paid in full with property which is liable for such payment. Each partner is liable *in solido* for the debts of the firm so that they are debts of each individual partner. A partnership is, therefore, insolvent only when the firm debts exceed the value of the property of the

firm, together with that of the partners applicable to the payment of firm debts.

"There are cases which hold that a partnership is insolvent when the firm property is insufficient to pay firm debts. These cases go upon the theory that the firm entity alone is to be considered. But the doctrine of partnership entity does not disturb substantive rights long recognized by courts of equity and bankruptcy. The better rule is that a firm is solvent while any of the partners are able to pay the firm debts."

Respectfully submitted,

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